

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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CC:ITA:B03

PLR-125774-06

Date:

September 14, 2006

LEGEND

Taxpayers =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Accountant =

Company =

\$a =

\$b =

\$c =

\$d =

\$e =

\$f =

Dear :

This responds to your letter dated May 10, 2006, which requests an extension of time under sections 301.9100-1 and -3 of the Procedure and Administration Regulations for you to make a late election to treat qualified dividends as investment income under sections 163(d)(1) and 163(d)(4)(B) of the Internal Revenue Code for Years 2 and 3.

FACTS

Taxpayers filed Form 1040 for Years 2 and 3. Taxpayers had investment interest expense in Year 2 of \$a and in Year 3 of \$b. This investment interest arose from a promissory note used to purchase the stock of Company which was executed in Year 1. In Years 2 and 3 Taxpayers received qualified dividends from Company in the amounts

of \$c in Year 2 and \$d in Year 3. The only other investment income Taxpayers had was taxable interest income in the amounts of \$e in Year 2 and \$f in Year 3.

Taxpayers relied on Accountant to complete and timely file their Year 2 and Year 3 Form 1040's. Pursuant to the Jobs and Growth Tax Relief Reconciliation Act of 2003, Accountant was aware that Taxpayers could not consider qualified dividends as investment income for purposes of computing the allowable investment interest deduction, unless Taxpayers elected to have the dividends taxed at the ordinary income tax rates.

However, Accountant was unaware of the need to file Form 4952 to make the election to treat the qualified dividends as investment income. On both the Year 2 and Year 3 Form 1040, Accountant treated the dividends received from Company as nonqualified so they would be taxed at the ordinary income tax rates, and took the investment interest expense deduction. However, Accountant failed to file Form 4952 electing to include the qualified dividends in investment income. So although the tax was computed correctly for electing to treat the dividends as investment income, the Form 4952 for making the election was not filed. Taxpayers were unaware of the need to file the election on Form 4952. In addition, Accountant did not discuss the treating of the qualified dividends as nonqualified ordinary dividends with the Taxpayers with respect to either the Year 2 or Year 3 Form 1040's. While preparing Taxpayers' Year 4 tax return, Accountant discovered the mistake, and notified Taxpayers of the need to seek a letter ruling granting permission to file a late election.

LAW

Section 163(d)(1) of the Code provides that in the case of a taxpayer other than a corporation, the amount allowed as a deduction for investment interest for any taxable year shall not exceed the net investment income of the taxpayer for the taxable year.

Section 163(d)(4)(B) of the Code provides, in part, that investment income means the sum of—

- (i) gross income from property held for investment (other than any gain taken into account under clause (ii)(I)),
- (ii) the excess (if any) of—
 - (I) the net gain attributable to the disposition of property held for investment, over
 - (II) the net capital gain determined by only taking into account gains and losses from dispositions of property held for investment, plus
- (iii) so much of the net capital gain referred to in clause (ii)(II) (or, if lesser, the net gain referred to in clause (ii)(I)) as the taxpayer elects to take into account under this clause. Such term shall include qualified dividend income (as defined in section 1(h)(11)(B)) only to the extent the taxpayer elects to treat such income as investment income for purposes of this subsection.

Section 1.163(d)-1(b) of the regulations provides that the election for qualified dividend income must be made on or before the due date (including extensions) of the income tax return for the taxable year in which the qualified dividend income is received.

Sections 301.9100-1 through 301.9100-3 of the Procedure and Administration Regulations provide the standards the Commissioner uses to determine whether to grant an extension of time to make a regulatory election. For this purpose section 301.9100-1(b) defines the term “regulatory election” as an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice or announcement published in the Internal Revenue Bulletin.

Section 301.9100-3(a) of the regulations provides that requests for extensions of time for regulatory elections (other than automatic changes covered under section 301.9100-2) will be granted when the taxpayer provides evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the Government.

Section 301.9100-3(b)(1) of the regulations provides that a taxpayer will be deemed to have acted reasonably and in good faith if the taxpayer—

- (i) requests relief before the failure to make the regulatory election is discovered by the Service;
- (ii) inadvertently failed to make the election because of intervening events beyond the taxpayer’s control;
- (iii) failed to make the election because, after exercising due diligence, the taxpayer was unaware of the necessity for the election;
- (iv) reasonably relied on the written advice of the Service; or
- (v) reasonably relied on a qualified tax professional, and the tax professional failed to make, or advise the taxpayer to make the election.

Section 301.9100-3(b)(3) of the regulations provides that a taxpayer will not be considered to have acted reasonably and in good faith if the taxpayer—

- (i) seeks to alter a return position for which an accuracy-related penalty could be imposed under section 6662 at the time the taxpayer requests relief and the new position requires a regulatory election for which relief is requested;
- (ii) was informed in all material respects of the required election and related tax consequences, but chose not to file the election; or
- (iii) uses hindsight in requesting relief. If specific facts have changed since the original deadline that make the election advantageous to a taxpayer, the Service will not ordinarily grant relief.

Section 301.9100-3(c)(1) of the regulations provides that the Commissioner will grant a reasonable extension of time only when the interests of the Government will not be prejudiced by the granting of relief. Under paragraph (c)(1)(i), the interests of the Government are prejudiced if granting relief would result in a taxpayer having a lower

tax liability in the aggregate for all taxable years affected by the election than the taxpayer would have had if the election had been timely made. Under paragraph (c)(1)(ii), the interests of the Government are ordinarily prejudiced if the taxable year in which the regulatory election should have been made, or any taxable years that would have been affected by the election had it been timely made, are closed by the period of limitations on assessment.

CONCLUSION

Taxpayers' election is a regulatory election, as defined under section 301.9100-1(b), because the due date of the election is prescribed in the regulations under section 1.163(d)-1(b). In the present situation, the requirements of sections 301.9100-1 and 301.9100-3 of the regulations have been satisfied. The information and representations made by Taxpayers establish that Taxpayers acted reasonably and in good faith with this request. Taxpayers relied on Accountant, a qualified tax professional, to prepare and file their tax returns, and Accountant failed to make or advise Taxpayers to make the election. Taxpayers are not seeking to alter a return position for which an accuracy-related penalty has been or could be imposed under section 6662 at the time relief is requested. The facts provided in the ruling request establish that the facts have not changed since the original election deadlines and that hindsight is not a factor in requesting relief.

Furthermore, granting an extension will not prejudice the interests of the Government. It is represented that the Taxpayers will not have a lower tax liability in the aggregate for all taxable years affected by the election if given permission to make the election at this time than Taxpayers would have had if the election had been made by the original deadline for making the election. Furthermore, the taxable year in which the regulatory election should have been made and any taxable years that would have been affected by the election had it been timely made, are not closed by the period of assessment.

Accordingly, Taxpayers are granted an extension of time for making the election until 60 days following the date of this ruling. The election should be made by filing a Form 4952, including a copy of this ruling, for both Year 2 and Year 3.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the Taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the Taxpayers and accompanied by a penalty of perjury statement executed by the appropriate parties. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Christopher F. Kane
Branch Chief, Branch 3
(Income Tax & Accounting)

cc: